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1. NAIC

National Association of Insurance Commission, which is an organization with no legal power but with substantial political clout. Commissioners of insurance in each state wield considerable power individually and exert influence collectively through NAIC.

2. Naked Option Writing

The owner of shares of common stock can write, or create, an option and sell it in the options market, in an attempt to increase the return or income on a stock investment. A more venturesome investor may create an option in this fashion without owning any of the underlying stock. This naked option writing exposes the speculator to unlimited risk because he or she may have to buy shares at some point to satisfy the contract at whatever price is reached. This is a serious risk if the value of the underlying asset has a high degree of variability.

3. Naked Options

The writing of a call or put option without owning the underlying asset is known as naked options. Naked options are much riskier than the covered options. [See also **Covered call**]

4. Naked Position

A short position in a call option that is not combined with a long position in the underlying asset. An alternative to a naked position, a financial institution can adopt a covered position which is a short position combining a long position in the underlying asset.

5. Naked Writing

Selling option without an offsetting position in the underlying asset.

6. Nasdaq

It represents the National Association of Securities Dealers Automated Quotation (Nasdaq). This automated quotation system is designed for the OTC market, showing current bid-asked prices for thousands of stocks.

7. Nasdaq Index

This index includes 4,000 over-the-counter (OTC) firms traded on Nasdaq market.

8. Negative Covenant

Part of the indenture or loan agreement that limits or prohibits actions that the company may take.

9. Negative Pledge Clause

A negative pledge clause in a debenture agreement states that any future debt-financed asset purchases also are considered to be security for the bond, even if the assets are financed with first mortgage bonds.

10. Neglected-Firm Effect

Small firms tend to be neglected by large institutional traders. It has been found by Arbel (1985) that investment in stock of this kind in less well-known firms has generated abnormal returns. [See also **January effect**]

11. Negotiable Certificates of Deposit

Negotiable certificates of deposit (CDs) are financial instruments offered by banks to customers who deposit funds for fixed periods at fixed rates of interest. CDs are issued in denominations of

\$100,000 or more, with maturities ranging to several years.

Yields on CDs are higher than yields on T-bills for two reasons. First, CDs are substantially less liquid than T-bills (their secondary market is very thin). Second, CDs have higher default risk because they represent unsecured debt obligations of the issuing banks. However, the spread between CD and T-bill yields varies depending upon economic conditions, supply and demand forces, and investor attitudes.

12. Negotiable Order of Withdrawal (NOW)

In 1980, Congress enacted depository institutions deregulation and monetary control act (DIDMCA). Titled III of DIDMCA authorized banks and financial institutions to offer interest-bearing transactions accounts. In banks and thrifts, they call this kind of account NOW account.

13. Negotiated Credit

Short-term bank credit is particularly important to the smaller company. Many large, well-established companies make little use of bank credit. When they need working capital above what is available as trade credit – that is, when they need negotiated credit, the term given to all credit that arises from a formal negotiation of funds – they can get attractive terms by borrowing directly from the capital market. This borrowing usually takes the form of selling commercial paper.

14. Negotiated Offer

The issuing firm negotiates a deal with one underwriter to offer a new issue rather than taking competitive bidding.

15. Negotiation

One technique used in business combinations is direct negotiation between the management teams

and the boards of directors of the two firms. After negotiations have been worked out, the plans are presented to both shareholder groups for approval.

Negotiation must identify what the firms will exchange, at what prices, and the method of payment. Assume that Firms A and B negotiate so that Firm B acquires all the assets (except cash) of Firm A and pays for these assets with its own cash. Now Firm A has cash as its only asset, and it may pay off its creditors and distribute any remaining cash as a liquidating dividend to its shareholders. If, however, Firm B pays for the assets of Firm A with its own shares of stock, then Firm A may sell off the stock and distribute the cash or distribute the stock directly to its shareholders. Note that the effect of these negotiations on the balance sheet of Firm B is an increase in the assets account, to reflect the acquired assets, and a decrease in cash or an increase in the capital accounts, to reflect the method of payment.

Assume now that Firm B acquires the common stock of Firm A (and not the assets directly). Firm B may acquire the shares for cash, either in exchange for some of its shares or by some more complex plan. In the extreme case in which the shareholders of Firm A surrender all their shares for shares of Firm B, Firm A ceases to exist and Firm B assumes all the assets and liabilities of Firm A. State laws specify that once a certain percentage of A's shareholders agree to an exchange of shares, all shareholders must comply. Holdout shareholders of Firm A may go to the courts to earn a fair price for their shares in the event that they are not satisfied with the negotiated price. In a less extreme case, Firm B may acquire less than all of the shares of Firm A and maintain an interest in Firm A. In this case, the shares of Firm A appear as an investment on the balance sheet of Firm B.

16. Net Cash Balance

Beginning cash balance plus cash receipts minus cash disbursements.

17. Net Float

Sum of disbursement float and collection float.
[See also **Float**]

18. Net Interest Margin

Ratio of net interest income to total earning assets;
used to evaluate profitability of banks.

19. Net Investment

Gross, or total, investment minus depreciation.

20. Net Operating Losses (NOL)

Losses that a firm can take advantage of to reduce taxes.

21. Net Overhead Burden

Difference between noninterest expense and non-interest income as a fraction of total bank assets.

22. Net Payoff

Another term for profit.

23. Net Present Value

The net benefit, or the net present value (NPV), of an investment is the present value of a project's cash flows minus its cost. The present value of the expected cash flows from a project is found by discounting each cash flow to the present. The *net present value* (NPV) is defined as:

Net present value = Present value of the expected cash flows – Cost of the project

More formally, NPV is:

$$\begin{aligned} \text{NPV} &= \frac{\text{CF}_1}{(1+r)^1} + \frac{\text{CF}_2}{(1+r)^2} + \dots + \frac{\text{CF}_N}{(1+r)^N} - I \\ &= \text{CF}_1[\text{PVIF}(r, 1)] + \text{CF}_2[\text{PVIF}(r, 2)] + \dots \\ &\quad + \text{CF}_N[\text{PVIF}(r, N)] \end{aligned}$$

where CF_t = annual cash flow generated by the project in period t ($t = 1, 2, \dots, N$); $\text{PVIF}(r, t)$ = present value factor for r percent in period t ; I = initial cost of the project; N = expected life of the project; r = required rate of return used to discount the cash flows.

It is a “net” present value in that it subtracts the project's investment cost from the present value of the project's expected cash flows.

24. Net Present Value Profile

Management may want to assess the sensitivity of a project's NPV to the required rate of return. An NPV profile shows this relationship in a graph of project NPVs for different values of the discount rate. The calculations and graphing of an NPV profile can be handled easily by a spreadsheet program.

If the resulting NPV profile shows a steeply sloped curve, then the NPV of the project under consideration is sensitive to the discount rate assumption. In such a case, management should carefully assess the project's required return. If the NPV profile is sloped gradually, then the project's impact on shareholder wealth is not very sensitive to changes in the discount rate.

25. Net Present Value Rule

An investment is worth making if it has a positive net present value (NPV). If an investment's NPV is negative, it should be rejected.

26. Net Working Capital

Net working capital, the difference between current assets and current liabilities, is a financial indicator that can be used in conjunction with ratio analysis to gauge a firm's liquidity. An increase in net working capital is a net investment in the firm's current assets; and an increase in an asset is considered a use of cash. A decrease in net working capital is a divestment of assets, that is,

a source of cash. In general, an abundance of net working capital suggests that the firm has ample liquidity to meet its short-term obligations.

$$\text{Net working capital} = \text{Current assets} \\ - \text{Current liabilities}$$

But this may not always be the case. In fact, one of the objectives of short-term financial planning is to reduce excess or redundant working capital to a minimum, since carrying these idle assets has both an explicit and implicit cost.

27. Net Worth

Owner's (stockholders') equity in a firm.

28. Netting

The practice of offsetting promised interest payments with promised interest receipts and transferring the difference with an interest rate swap. [See also **Interest rate swap**] There are at least three types of netting:

- (a) *Close-out netting*: In the event of counterparty bankruptcy, all transactions or all contracts of a given type are netted at market value. The alternative would allow the liquidator to choose which contracts to enforce and which to not to (and thus potentially "cherry pick"). There are international jurisdictions where the enforceability of netting in bankruptcy has not been legally tested.
- (b) *Netting by novation*: The legal obligation of the parties to make required payments under one or more series of related transactions are canceled and a new obligation to make only the net payment is created.
- (c) *Settlement or payment netting*: For cash settled trades, this can be applied either bilaterally or multilaterally and on related or unrelated transactions.

29. Newton-Raphson Method

The Newton-Raphson procedure is designed to solve an equation of the form $f(x) = 0$. It starts with a guess of the solution: $x = x_0$. It then produces successively better estimates of the solution: $x = x_1, x = x_2, x = x_3, \dots$ using the formula $x_{i+1} = x_i - f(x_i)/f'(x_i)$. Usually, x_2 is extremely close to the true solution.

30. No Loan Fund

A mutual fund that does not charge a regular sales commission or sale charge. In other words, there are no front end sales charges.

31. No-Arbitrage Assumption

The assumption that there are no arbitrage opportunities in market prices.

32. No-Arbitrage Interest Rate Model

A model for the behavior of interest rates that is exactly consistent with the initial term structure of interest rates. [See also **Term structure of interest rates**]

33. Nominal Cash Flow

A cash flow expressed in nominal terms if the actual dollars to be received (or paid out) are given.

34. Nominal Interest Rate

When the bond interest rate is quoted as an APR, it is called a nominal interest rate or **stated annual interest rate**. Given an annual percentage rate, the periodic interest rate is APR/m , where m represents the number of periods or cash flows in a year. Since APR assumes no period-by-period compounding of cash flows, it fails to account for interest-on-interest.

35. Nominal Risk-Free Interest Rate

Potential savers have little incentive to invest unless their expected returns include some protection against expected inflation. To try to protect themselves from a loss of purchasing power, investors will demand a return that reflects inflationary expectations. This return is called the nominal risk-free interest rate; it represents the observed or published return on a risk-free asset.

The nominal risk-free rate depends upon: the **real risk-free rate** and the expected inflation rate. [See also **Real risk-free rate**]

$$\begin{aligned} & \text{Nominal risk-free interest rate} \\ &= (1 + \text{Real risk-free interest rate}) \\ & \quad \times (1 + \text{Expected inflation rate}) - 1. \end{aligned}$$

This equation, known as the Fisher effect, illustrates how the inflation rate determines the relationship between real and nominal interest rates.

Many financial analysts use the interest rate on a one-year Treasury bill to approximate the nominal risk-free rate. The Treasury bill (T-bill) has a short time horizon and the backing of the US government, which give it an aura of safety. The one-year T-bill rate is used because investment returns usually are stated as annual returns.

36. Nonbank Bank

A firm that either makes commercial loans or accepts deposits but does not do both. Thus, it avoids regulation as a commercial bank. In other words, it undertakes many of the activities of a commercial bank without meeting the legal definition of a bank.

37. Nonbank Subsidiary

A subsidiary of a bank holding company that is engaged in activities closely related to banking, such as leasing, data processing, factoring, and insurance underwriting.

38. Noncash Item

Expense against revenue that does not directly affect cash flow, such as depreciation and deferred taxes.

39. Nondebt Tax Shields

If firms pay taxes and interest is tax-deductible, firm value rises as the use of debt financing rises. But this analysis implies that there are limits to the benefits of tax-deductible debt. For example, business risk leads to variations in EBIT over time, which can lead to uncertainty about the firm's ability to fully use future interest deductions. If a firm has a negative or zero operating income, an interest deduction provides little help; it just makes the pretax losses larger. The advantage of tax-deductible interest also is reduced if the firm has tax-loss carry forwards that reduce current and future years' taxable incomes. Also, firms in lower tax brackets have less tax incentive to borrow than those in higher tax brackets.

The present value of future interest tax shields becomes even more uncertain if EBIT is affected by nondebt tax shields. In practice, firms' EBITs are reduced by various expenses, such as depreciation, depletion allowances, amortization, pension contributions, employee and retiree health-care costs, **R&D**, and advertising expenses. Foreign tax credits, granted by the US government to firms that pay taxes to foreign governments, also diminish the impact of the interest deduction. Thus, the tax deductibility of debt becomes less important to firms with large nondebt tax shields.

40. Nondiversifiable Risk

Risk that remains after a large number of assets are combined in a portfolio. [See also **Systematic risk**]

41. Nonmarketed Claims

Claims that cannot be easily bought and sold in the financial markets, such as those of the government and litigants in lawsuits.

42. Nonnotification Financing

[See **Pledging**]

43. Nonperforming Loan

Loan for which an obligated interest payment is 90 days past due. They are placed on accrual status. Banks have traditionally stopped accruing interest when debt payments were more than 90 days past due.

44. Nonrate Gap

Noninterest-bearing liabilities plus equity minus non-earning assets as a ratio of earning assets.

45. Nonrated Bond

A bond that is not rated by Moody's, **S&P**, or other rating agency.

46. Nonrecombining Tree

A binomial tree describing asset price moves in which an up move followed by a down move yields a different price than a down move followed by an up move.

47. Nonrecourse

Holder of an obligation has no legal right to force payment on a claim.

48. Nonstandard Option

[See **Exotic option**]

49. Nonstationary Model

A model where the volatility parameters are a function of time.

50. Nonsystematic Risk

Nonmarket or firm-specific risk factors that can be eliminated by diversification. Also called unique

risk or diversifiable risk. Systematic risk refers to risk factors common to the entire economy.

51. Normal Backwardation Theory

Normal backwardation is one of the three traditional theories used to explain the relationship between the futures price and the expected value of the spot price of the commodity at some future date. Normal backwardation suggests that the futures price will be bid down to a level below the expected spot price, and will rise over the life of the contract until maturity date. On the maturity date, futures price is equal to spot price. [See also **Expectations hypothesis**]

52. Normal Distribution

System metric bell-shaped frequency distribution that can be defined by its mean and standard deviation. It's a systematic distribution and therefore the skewness of normal distribution is zero. It is a continuous probability distribution that assigns positive probability to all values from $-\infty$ to $+\infty$. Sometimes called the "bell curve."

The probability density function of a normal random variable can be defined as:

$$f(x) = \frac{1}{\sqrt{2\pi\sigma}} e^{-(x-\mu)^2/2\sigma^2}, \quad -\infty < x < \infty,$$

where $\pi = 3.14159$, $e = 2.71828$, and $\mu(-\infty < \mu < \infty)$ and $\sigma^2 (0 < \sigma^2 < \infty)$ are the mean and variance of the normal random variable x . [See also **Central limit theorem**]

53. Normal Market

A market where futures prices increase with maturity.

54. Note

Unsecured debt, usually with maturity of less than 15 years. Note payable is one of the liability items in the balance sheet.

55. Note Issuance Facility

An arrangement in which borrowers can issue short-term securities in their own names.

56. Notional Amount

The dollar amount used as a scale factor in calculating payments for a forward contract, futures contract, or swap.

57. Notional Principal

The principal used to calculate payments in an interest rate swap. The principal is “notional” because it is neither paid nor received.

58. Notional Value

The face value of interest rate swap contracts; a mere reference value to compute obligated interest payments.

59. NPV

Net Present Value = present value of expected cash flow – cost of the project.

[See also **Net present value**]

60. NPVGO Model

A model valuing the firm in which net present value of new investment opportunities is explicitly examined. NPVGO stands for net present value of growth opportunities. This model divided the dividend growth model into two parts as value of share when firm acts as cash cow plus NPV of growth opportunity. [See also **Cash cow** for value of a share]

61. NSF

Not sufficient funds.

62. Numeraire

Defines the units in which security prices are measured. For example, if the price of IBM is the numeraire, all security prices are measured relative to IBM. If IBM is \$80 and a particular security price is \$50, the security price is 0.625 when IBM is the numeraire.

63. Numerical Procedure

A method of valuing an option when no formula is available.